LEGISLATIVE
AUDIT
COMMISSION

Review of
Office of the State Treasurer
Fiscal Officer Responsibilities
Financial and Compliance Audit
Year Ended June 30, 1997

622 Stratton Office Building
Springfield, Illinois 62706
217/782-7097

REVIEW: 4058
OFFICE OF THE STATE TREASURER
FISCAL OFFICER RESPONSIBILITIES
YEAR ENDED JUNE 30, 1997

FINDINGS/RECOMMENDATIONS - 2
IMPLEMENTED - 2

REPEATED RECOMMENDATIONS - 0

PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 1

This review summarizes an audit of the Office of the State Treasurer, Fiscal Officer Responsibilities, for the year ended June 30, 1997, filed with the Legislative Audit Commission May 13, 1998. The auditors performed a financial and compliance and state the financial statements for the Office are fairly presented.

The Treasurer is custodian of the State's cash investments and is accountable for the balances in the separate funds which are considered to be either in the State Treasury or outside the State Treasury. Accounting control for funds outside the State Treasury is the responsibility of other State agencies.

The Treasurer's investment policies are governed by State statute. In addition, the Treasurer's Office has adopted its own investment practices which supplement the statutory requirements. Cash received by the Treasurer is initially deposited in clearing accounts maintained in banks located in Illinois which are FDIC insured. Surplus funds, as determined by the Treasurer, may be invested in time deposits, certificates of deposit and other interest-bearing accounts, credit unions, short-term obligations of corporations, repurchase agreements, or other investments approved by State law.

During the one-year period covered by the audit, the Honorable Judy Baar Topinka was Treasurer.

Balance Sheet Information

Appendix A presents comparative balance sheets for the fiscal officer accounts of the State Treasurer at June 30, 1997 and 1996. The statements of assets, liabilities, and accountabilities of investment income do not present the financial position of the Treasurer and results of investment activity in accordance with generally accepted accounting principles because, with two exceptions, the statements only present those assets and activities for which the Treasurer is held accountable by statute in her fiscal officer responsibilities. The exceptions are the securities, funds and other assets of the Illinois Public Treasurers' Investment Pool (IPTIP), and amounts receivable from inheritance tax assessments. The financial statements of IPTIP are audited annually and reported upon separately.

Revenue producing deposits and investments are detailed on the balance sheet. Most investments are short-term due to the need for liquidity. Long-term investment in the pooled accounts are generally authorized by statute. In addition, the Treasurer's office has adopted its own investment practices which supplement the statutory requirements. Time deposits awarded to banks under various programs yielded 4.57% in FY97 and 5.54% in FY96. The average yield for all short-term investments during FY97 and FY96 was 4.65% and 5.34%, respectively. Deposits and investments stood at $5,534,707,070 at June 30, 1997 compared to $5,103,127,777 at June 30, 1996. Of this total as of June 30, 1997, $4,924,8332,488 (89%) was in short-term investments and $609,874,582 (11%) in long-term investments. This compares to June 30, 1996 when 85.8% was in short-term investments, and 14.2% in long-term investments.

The Treasurer's investment portfolio earned $258,894,395 during FY97. Investments yielded approximately 5.4% throughout the year. The average investment base increased approximately $236,000,000 from FY96. The portfolio decreased discounted deposits of approximately 46% to $137,700,000 from FY96.

The liability for general obligation indebtedness is the aggregate amount of all future principal and interest payments necessary to retire such outstanding debt.

Cash and Deposits

Appendix B provides information pertaining to cash and deposits. A detailed listing by bank is also included. The bank balances represent all funds recorded by the financial institution. Demand deposit accounts are the principal accounts used to process cash and investment transactions within the State Treasury. The carrying amount of all the Treasurer's demand deposits and clearing account deposits at June 30, 1997 was $40,950,602.

The principal method of payment for receipt and disbursement processing services provided by banks is by warrant from the Treasurer's Bank Services Trust Fund appropriation. Beginning in 1993, the Treasurer began paying for most bank processing services from the Bank Services Trust Fund. The Treasurer had conducted a pilot program to compare the cost of paying for bank services by compensating balances as compared to the direct fee method. The pilot demonstrated the effective cost to the State of banking services could be reduced if the State paid for services by direct fee.

Agencies' Deposits Outside the State Treasury

Appendix C provides a summary of agency deposits held outside the Treasury which totaled $429,915,492 as of June 30, 1997, compared to $373,819,184 as of June 30, 1996. The Treasurer's liability for agencies' deposits outside the State Treasury is composed primarily of deposits for municipal and county retailer occupation taxes, and State income taxes awaiting account designations before deposit in the State Treasury. Agencies' deposits outside the State Treasury consist principally of cash and short-term investments.

Administrative Responsibilities

The Treasurer's fiscal officer responsibilities include joint responsibility with the Attorney General for the collection and receipt of inheritance and estate taxes assessed by the circuit courts and the Attorney General, respectively, and collected by the 102 county treasurers. Gross inheritance and estate tax receipts for FY97 and FY96 amounted to $208,843,255 and $186,178,297, respectively. These amounts do not reflect refunds and fees distributed to county treasurers.

Illinois Insured Mortgage Pilot Program Trust

The Illinois Insured Mortgage Pilot Program Trust (the Trust) was created in October of 1982 in order to stimulate construction activity in the State. The State purchased $120 million of certificates for which the underlying security was a pool of mortgage loans issued by American National Bank and Trust Company of Chicago for the purpose of providing financing to approved construction projects. The principal terms of the loans required "interest only" payment for seven years following the completion of construction with full payment of the outstanding principal balance at the end of the seventh year.

Prior to July 1, 1990, $69,790,000 of loans had been repaid prior to maturity. The remaining balance of $50,210,000 was loaned under seven mortgage agreements. Three mortgage agreements, originally totaling $40,650,000, were secured by hotel properties. The other four mortgage agreements, originally totaling $9,560,000, were secured by commercial properties.

Commercial Properties: The four commercial loans totaling $9,560,000 owned by the Trust were restructured during FY89. The interest rates were reduced from 12-1/4% to 8% per annum retroactive to January 1, 1988. Monthly interest payments were required and all principal was due upon maturity.

Cary Space Center: As of June 1, 1992, the borrower in one commercial property, Cary Space Center, had defaulted on the loan agreements through failure to pay interest and real estate taxes. On July 7, 1992, the borrower and the trustee entered into a workout agreement to cure the arrearage, pay the taxes, and provide for the sale of the security on the loan. All monthly payments due during FY93 were received. After the borrower failed to comply with provisions of the workout agreement, the deed, in lieu of foreclosure, was delivered and recorded on August 3, 1993. On June 20, 1994 the property was sold for $2,130,000. Net proceeds received by the Treasurer totaled $2,293,979, which represents net sale proceeds. The Treasurer received return of the entire principal amount and all but $4,679 in interest which would have been recorded through the date of sale.

Hamilton Center: A loan on a second commercial property, Hamilton Center, was restructured on September 4, 1992. The agreement subordinated the mortgage lien on the property in the amount of $115,000 in order for the borrower to obtain financing from an unrelated third party. In addition, the maturity date was extended one year to January 12, 1996. Additionally, the monthly payment was increased to $15,893 and included principal as well as interest. During FY94, the borrowers of Hamilton Center obtained private financing and the note to the Trust was paid off in its entirety, including all interest due.

Park Plaza: Due to a failure to perform as agreed, the Trustee declared a default on the loan to the Park Plaza Shopping Center on August 1994. On October 28, 1994, the Trustee drew $100,000 on the letter of credit held as additional collateral on this loan. On November 1, 1994, the Trustee filed a complaint for foreclosure on the Park Plaza Shopping Center. In December 1994, the Treasurer began collecting rent directly from the tenants of the Park Plaza Shopping Center. The outstanding balance for this agreement has been classified as a nonperforming asset for financial reporting purposes. The accrued interest receivable at June 30, 1997 was approximately $734,000, and because the investment is classified as a nonperforming asset, the accrued interest receivable has not been recorded in the financial statements. In order to preserve its rights under a surety bond valued at approximately $489,000 and serving as collateral for the loans to the developers of the Park Plaza Shopping Center, the Trustee filed suit against the surety on January 17, 1997. Since the bond requires the Trustee to obtain merchantable title before recovering under the bond, the amount has not been included in the recorded value of the commercial property.

Geneva on the Dam: On October 28, 1994 the Trustee signed a restructuring agreement with the borrowers of the Geneva on the Dam property. The terms of this agreement require a payment of $150,000 upon signing and monthly payments which include principal on a 15-year amortization schedule. The interest rate remains at 8% and the maturity date was extended to January 12, 2000. Since the signing of this restructuring agreement, all monthly payments due have been received. On August 11, 1997, the Treasurer received a payoff of $2,276,339 representing the unpaid principal and interest on the Geneva on the Dam note. The payoff will be reflected in the year ended June 30, 1998 financial statements.

The following is a summary of the balances related to the remaining commercial properties as of June 30, 1997:

Commercial Properties
(In Thousands)

	Cary Space Center	Park Plaza Shopping Center	Hamilton Center	Geneva on the Dam	Total
Original Loan Balances	$1,650	$3,260	$1,900	$2,750	$9,560
Less 1995, 1996 & 1997 payments		(814)		(483)	(1,297)
Less 1993 & 1994 write-down		(1,610)		(250)	(1,860)
Loan payoff	1,650		1,842		
June 30, 1997 -- recorded value		836		2,017	2,853
June 30, 1997 -- loan balances		2,446		2,267	4,713

<u>Hotel Properties</u>: The three hotel loans, totaling $40,650,000, owned by the Trust, were restructured in FY88. The restructured agreements extended the maturity from various dates in 1990 through 1992 to January 12, 1995. Monthly interest payments were required and all principal was due upon maturity. The average interest rates were reduced from 12-1/4% to 8% per annum. Under the terms of the agreements, $6,423,000 of past-due interest was capitalized. It was the Treasurer's position that collection of the capitalized interest was uncertain and thus was not added to the recorded value. Additionally, portions of the loan balances, including the capitalized interest, were guaranteed by a surety bond and letters of credit.

<u>Renaissance-Springfield</u>: One of the hotels, with an original loan balance of $15,500,000 (Renaissance-Springfield), entered into a second restructuring agreement on April 30, 1990 retroactive to January 1, 1990. The agreement requires quarterly payments based on cash flow, applied first to any outstanding principal. Interest is charged at 6% per annum on the outstanding principal; however, this interest is deferred until the principal has been satisfied and no interest is charged on deferred interest. In addition, the maturity date was extended to January 1, 2010; however, if the sum of unpaid principal and interest deferral exceed $18 million at any time after January 1, 1999 the loan becomes immediately due by default. (As of June 30, 1997 and 1996, the unpaid principal and interest totaled approximately $20,996,000 and $20,333,000, respectively.)

The amended surety bond under the current restructured agreement requires the borrower, at the borrower's expense, to maintain a surety bond guaranteeing to the lender all or a portion of the principal amount. The lender has 45 days upon default to notify the surety that there is a default and potential claim against the surety bond. Once the lender has obtained merchantable title, it can proceed with a claim against the surety bond. The estimated present value of the surety bond as of June 30,1997 and 1996 was $2,860,878 and $2,612,674, respectively.

Holiday-Inn, Collinsville: The second hotel (Holiday-Inn, Collinsville), with an original loan balance of $13,400,000, signed a second restructuring agreement on January 10, 1991. The terms of this agreement are similar to those of the agreement with the Renaissance-Springfield, that results in required payments based on a calculation of defined cash flow, which are applied first to outstanding principal. The maturity date was extended to January 1, 2010; however, if at any time after January 1, 1999, the sum of unpaid principal and interest deferrals exceeds $17.7 million, the loan becomes immediately due by default. (The unpaid principal and interest totaled approximately $22,049,000 and $21,294,000, respectively, as of June 30, 1997 and 1996).

The agreement required, as additional security for the loan, the borrower, at the borrower's expense, must maintain and keep in force during the term of the loan one or more unconditional, irrevocable, letters of credit in an amount not less than 15% of the principal amount. At a default date, the borrower has the option of providing additional collateral equal to either the maximum amount of $3,060,000, or 64%, of the loss. The estimated present value as of June 30, 1997 and 1996, respectively, of the additional collateral equals $2,713,332 and $2,506,542. Pursuant to the restructuring agreement, the Collinsville mortgage is also secured by a personal guarantee in the maximum amount of $1,500,000. However, personal financial statements from the guarantors are not readily available, and thus the estimated value of the guarantee is unknown.

Ramada-Mt. Vernon: On October 29, 1992 at the direction of the Treasurer, with the concurrence of the Governor, the Trustee signed a letter of intent with the debtor of the Ramada-Mt. Vernon hotel to accept $8,300,000 as final payment of the debt with an original loan balance of $11,750,000. The total loss realized by the Trust for this property was approximately $5,859,000 in principal, and $493,000 in accrued interest, for a total of $6,352,000.

The two hotel loans still outstanding are considered to be nonperforming assets, and as such, interest is recorded only if received. If interest were recorded, the accrued interest balances for the hotels at June 30, 1996 and 1997 would be as follows:

	Springfield	***Collinsville***	***Total***
Accrued interest receivable - June 30, 1996	$6,043,000	$5,579,000	$11,622,000
Accrued interest receivable - June 30, 1997	$ 6,891,000	$ 6,514,000	$ 13,405,000

As of June 30, 1994, the Treasurer recorded a provision of $19,615,000 for the write-down of the loan balances to reflect the permanent impairment of the Springfield and Collinsville hotels based on the most recent independent note valuations of each of the hotel properties. There have been no write-downs since 1994.

Following is a summary of the balances related to the restructured loans:

(In Thousands)	*Renaissance -Springfield*	*Holiday Inn-Collinsville*	*Total*
Original loan balances	**$ 15,500**	**$ 13,400**	**$ 28,900**
Less payments - 1991-1997	(2,027)	(2,040)	(4,067)
Less write-downs - 1991-1994	(11,159)	(8,456)	(19,615)
Adjustment/correction of an error	(1,305)	3,868	2,563
June 30, 1996 Recorded Value	**$ 1,009**	**$ 6,772**	**$ 7,781**
Loan Balance -			
Original loan balance	**$ 15,500**	**$ 13,450**	**$ 28,900**
June 30, 1997 loan balance	**$ 14,105**	**$ 15,535**	**$ 29,640**

Accountants' Findings and Recommendations

Condensed below are the two findings and recommendations presented in the audit report. There were no repeated recommendations. The following recommendations are classified on the basis of information provided by Judy Baar Topinka, State Treasurer, in a letter dated March 19, 1999.

Implemented

1. **Comply with the State Treasurer Employment Code by immediately appointing a third member and holding four meetings of the Personnel Review Board during each fiscal year.**

Findings: The Treasurer's Office did not have four Personnel Review Board meetings as required by the State Treasurer Employment Code and the Office did not have the required amount of members on the Personnel Review Board.

Response: Implemented. The Treasurer appointed the necessary number of members to the Personnel Review Board on October 16, 1997 and their appointments were confirmed by the Senate on May 21, 1998. The Board is scheduled to meet quarterly.

Implemented - concluded

2. **Prepare and send in a timely fashion, monthly reports for the Attorney General to account for the amount of money in the Violent Crime Victims Assistance Fund.**

<u>Findings</u>: The Treasurer's Office did not provide the Attorney General with a monthly report of the amount of money in the Violent Crime Victims Assistance Fund.

<u>Response</u>: Implemented. In January 1998, the Treasurer's Office began preparing monthly reports summarizing the activity of the Violent Crime Victims Assistance Fund. The Office has continued to generate a monthly activity report of the Fund for the Attorney General.

Emergency Purchases

The Illinois Purchasing Act (30 ILCS 505/1) states that "the principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts ..." The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies "involving public health, public safety, or where immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage ... prevent or minimize serious disruption in State services or to insure the integrity of State records."

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

During FY97, the Treasurer did not file any affidavits for emergency purchases.

Headquarters Designations

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission. Each State Agency is required to file reports of all its officers and employees for whom official headquarters have been designated at any location other than that at which official duties require them to spend the largest part of their working time.

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The Treasurer's Office indicated as of July 1997 that four employees are assigned to locations other than official headquarters.

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